Synopsis

Tax today

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A monthly journal, published by PwC South Africa, that gives informed commentary on current developments in the tax arena, both locally and internationally.

Through analysis of and comment on new laws and judicial decisions of interest, Synopsis helps executives to identify developments and trends in tax law and revenue practice that may affect their business.

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When is a debt considered bad?

In May 2023, the South African Reserve Bank increased the repo rate by 50 basis points to 8.25 percent. The increased rate may influence the cost of borrowing and impact the ability of certain borrowers to satisfy their repayment obligations. In *PwC's recent analysis of major South African banks' results for the reporting period ended 30 June 2023*, the following comments noted on credit rating bear repeating:

> "Higher interest rates drove up instalments and dampened affordability, as South African households felt the burden of larger debt repayments, less disposable income and higher debt-to-income ratios. This consumer distress increased the cost of risk — particularly in home loans, vehicle and asset finance and personal loan portfolios — while consumer-facing corporate sectors and sovereign risks in certain territories amplified credit risks across portfolios. The combined credit loss ratio (measured as the income statement impairment charge divided by average advances) deteriorated to 107 bps (1H22: 76 bps) as the income statement impairment charge increased 59.5% compared to 1H22. Total non-performing loans increased 23%, now comprising 5.2% of gross loans and advances (1H22: 4.6%)."

The dampened affordability and lesser disposable income, among other factors, may result in some of the debts receivable by moneylenders becoming doubtful or bad. Similarly, retailers who sell on credit may have some of the debts receivable becoming doubtful or bad due to, among other reasons, consumers having decreased disposable income.

The concept of bad debt, albeit neither new to the Act[1] nor tax, is not defined in the Act.

Whether a debt is considered bad (i.e. irrecoverable) is relevant for a number of sections in the Act including: (i) under section 11(a) read with section 23(g), a moneylender can deduct losses relating to debts which are bad; (ii) under section 11(i), a taxpayer can deduct any amount of previously or presently included income which has become bad; and (iii) under section 24I, in the context of foreign denominated debt receivables which are irrecoverable by reason of becoming bad, the lender is allowed to deduct from or include in income, as the case may be, the related cumulative foreign exchange gains or losses included in income previously or presently.

This article discusses when a debt can be considered as bad. In this regard, it is apposite to consider what the term 'debt' means. The term is defined for specific purposes in certain sections and paragraphs of the Eighth Schedule to the Act, including section 19 and paragraph 12A. Other sections such as section 23M and section 41 also indicate what the term includes. There seems to be no general definition to the term in the Act.

The general rules of interpretation as noted by Wallis JA in the *Endumeni Municipality*[2] case is that an undefined term in the Act must be given its ordinary grammatical meaning. The online Cambridge dictionary[3] defines the term 'debt' as:

> "[S]omething, especially money, that is owed to someone else, or the state of owing something"

1 Income Tax Act No. 58 of 1962 as amended.
2 Natal Joint Municipal Pension Fund v Endumeni Municipality [2012] 2 All SA 262 (SCA).
3 https://dictionary.cambridge.org/dictionary/english/debt [Accessed on 13 October 2023].

In *First National Bank of SA Ltd v Lynn No and Others*[4], the court stated that 'a debt is what is due from an obligation'. The court also considered The Oxford English Dictionary, which states that 'due' means that which is owing or payable as an enforceable obligation or debt (an adjective) and that which is owed or due, anything (as money, goods or services) which one person is under obligation to pay or render to another (a noun).

It is readily apparent that amounts owed to retailers, in respect of sales on credit, and moneylenders, in respect of loans, to name a few, will qualify as debt since the relevant debtors have an unconditional obligation to make repayments in respect the amounts owed.

As stated, the term 'bad debt' is not defined in the Act. The Cambridge Dictionary defines a bad debt as 'a debt that is not likely to be paid'. It is noteworthy to mention the use of the phrase 'not likely' which postulates some degree of uncertainty that the debt will not be repaid as opposed to an absolute certainty that it will not be repaid.

In ITC 592[6], a taxpayer had granted credit to customers on terms that extended over several years before finally writing some of them off as bad. As to when the debts became bad, Ingram CJ stated that:

> "Taking into consideration the appellant's method of doing business as found above, the Court accepts his statement contained in his letter above referred to, ***that it was not until the year 1943 that he definitely came to the conclusion that the debts he now claims to deduct, were wholly bad and irrecoverable. Applying, therefore, the principle laid down above that the taxpayer is entitled to claim the deduction of bad debts up to and as at the time he finally regards the debts to be bad…***"

In essence, a taxpayer can make a subjective assessment of a debt owed by a third party and conclude that the debt is bad. Even though a taxpayer is entitled to make such an assessment, this subjective assessment should be supported by some objective evidence that indeed the debt in question is irrecoverable when one considers the burden of proof requirements under section 102 of the TAA[7].

In ITC 1284[8], the taxpayer sought to claim an amount of USD72,000 as a bad debt deduction in respect of an outstanding amount of USD80,000 due to the taxpayer. The outstanding amount was secured by 50,000 shares valued 16c per share.

The Commissioner disallowed the deduction on the basis that the taxpayer had not proved (i) that it had decided, on or before 31 March 1976, to write off the sum of USD72,000 or (ii) that the loss of that sum had been incurred in the tax year ending 31 March 1976. The taxpayer appealed to the Special Court which held that:

> "The reference in [ITC 592] to a debt becoming wholly irrecoverable ***does not appear to me to have been intended to convey that a taxpayer cannot claim to deduct part of a debt which has become irrecoverable***...To allow the appellant's claim to deduct its ***undoubted loss in respect of its loan to 'A' Ltd to remain in limbo for years would give rise to an unwarranted distortion of its just liability to tax***…I am satisfied, therefore, that ***the appellant was entitled to write off the debt***… in its accounts for 1975/6 and to have that amount deducted from its income as a loss incurred by it."

The Commissioner, unsatisfied with the outcome, appealed the matter to the High Court, Rhodesia (Appellate Division) which reaffirmed the conclusion by concluding that '[the Special Court] correctly found that the whole loss of [USD]72,000 had been established on a balance of probability, and should have been allowed as a deduction during the tax year ending 31 March 1976.' (our emphasis)

4 1996 (2) SA 339 (SCA).

5 https://dictionary.cambridge.org/dictionary/english/bad-debt [Accessed on 13 October 2023].

6 ITC 592 (1945) 14 SATC 243 (U) at 246.

7 Tax Administration Act No. 28 of 2011 as amended.

8 (1978) 41 SATC 45(R).

The taxpayer in ITC 1284 made a subjective assessment regarding the sum of USD72,000 as bad and supported that assessment with objective evidence. Even though there were some questions regarding the quantum of amount regarded as bad, the court accepted the estimated amount based on the facts.

When assessing whether a debt is bad, it is important that the assessment is performed with reference to the existing circumstances of the debtor at that time with no regard for subsequent events.[9] This is of particular importance given that tax is an annual event and each year is considered in isolation — events which may have an effect upon a taxpayer's liability to normal tax are relevant only in determining his tax liability in respect of the fiscal year in which they occur, and cannot be relied upon to re-determine such liability in respect of a fiscal year in the past.[10]

It follows that for a debt to be regarded as bad in a specific year of assessment, a debt must have become irrecoverable for the first time during that year.[11] In ITC 181[12], the taxpayer was unsuccessful in his attempts to recover, between the years 1923 to 1928, the amounts due to him and the irrecoverable amounts mounted up to a considerable sum.

During the year of assessment ended 30 June 1929, the taxpayer sought to deduct this accumulated loss against his income for that year as being an accumulation of bad debts. This claim was rejected by the Commissioner following which the taxpayer appealed to the tax court.

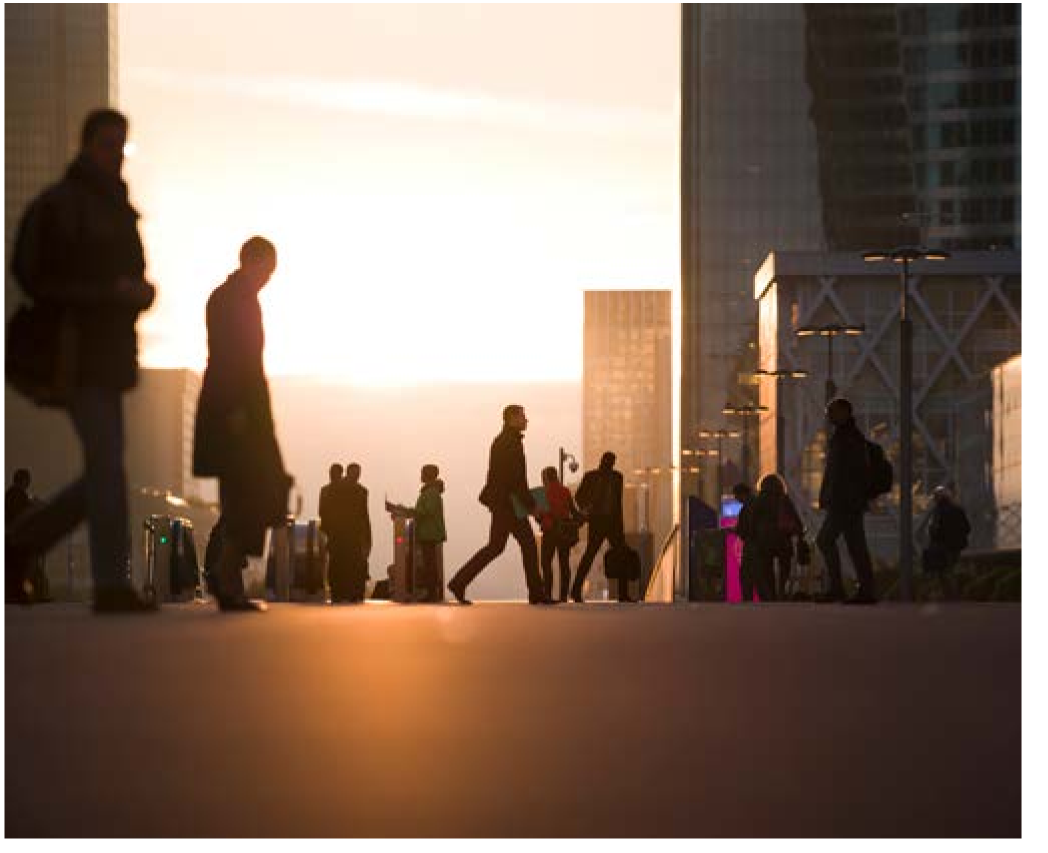
The court, dismissing the appeal, noted that in view of the fact that all the amounts making up the sum claimed as a deduction were known by the appellant to be irrecoverable prior to the year of assessment under review, they were not admissible as deductions in determining the taxable income of that year of assessment. The principles in ITC 181 were confirmed in ITC 253.[13]

Taxpayers often perform an assessment of whether a debt is bad when the debt is written off for financial reporting purposes. The accounting rules may be useful; however, it is not the key determinant. There is no provision in the Act which suggests that a debt has to be formally written off in the tax year before it can be claimed as a deductible tax loss in that year.[14]

SARS' Comprehensive Guide to Capital Gains Tax (Issue 9) (the 'CGT Guide')[15] states that SARS accepts that a debt will become irrecoverable when the taxpayer has exhausted all reasonable steps to recover it. In arriving at this conclusion, the CGT Guide[16] refers to case law of other countries and also the approach adopted by other revenue authorities.

This seems to suggest that where a taxpayer regards a debt as irrecoverable (bad) based on objective evidence at the time that the bad debt assessment is performed having regard to the existing circumstances of the debtor, the taxpayer still needs to demonstrate that it has exhausted all reasonable steps to recover the debt. This is not in line with the case law that we have highlighted above.

It is worth noting that the CGT Guide does not constitute practice generally prevailing and, furthermore, it is not binding on taxpayers. It is appropriate to mention the principles laid down by our courts with regard to reliance on SARS documents such as Interpretation Notes, and the effect of these documents on the proper meaning to be attributed to statutory provisions.



9 CIR v Delfos 1933 AD 242, 6 SATC 92 at 105; Caltex Oil (SA) Ltd v SIR 1975 (1) SA 665 (A), 37 SATC 1 at 15.
10 Caltex Oil (SA) Ltd v SIR 1975 (1) SA 665 (A) at 677H-678A.
11 C f BT (Pvt) Ltd v Zimbabwe Revenue Authority (2015) 77 SATC 204.
12 (1930) 5 SATC 258(U).
13 (1932) 7 SATC 53(U).
14 Commissioner of Taxes v A Company 41 SATC 59 High Court, Rhodesia (Appellate Division).
15 Page 855.
16 Comprehensive Guide to Capital Gains Tax.

In *Marshall N.O. and Others v Commissioner for the South African Revenue Service,*[17] Froneman J observed the following:

> "Why should a unilateral practice of one part of the executive arm of government play a role in the determination of the reasonable meaning to be given to a statutory provision? It might conceivably be justified where the practice is evidence of an impartial application of a custom recognised by all concerned, but not where the practice is unilaterally established by one of the litigating parties. In those circumstances it is difficult to see what advantage evidence of the unilateral practice will have for the objective and independent interpretation by the courts of the meaning of legislation, in accordance with constitutionally compliant precepts. It is best avoided."

In the judgment in Marshall, SARS' interpretation of statutory provisions is revealed as lacking independence, and as being the view of only one of the litigants in any tax dispute. Essentially, a court should consider the interpretation of the words used in a statute objectively and independently.

The takeaway

The term bad debt is not defined in the Act. Taxpayers are advised to assess the facts and circumstances relating to a specific debt in order to conclude if such debt has become bad. Such assessment should be backed by objective evidence and this must be documented appropriately. We recommend that taxpayers consult with their advisers particularly given SARS' view on when a debt is considered bad.

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17 Case CCT 208/17 [2018] ZACC 11.

South Africa's controlled foreign company (CFC) tax regime – an outlier?

Introduction

In this article we compare the design of South Africa's (SA) CFC legislation (contained in section 9D of the Income Tax Act) to that of other countries and consider whether SA has succeeded (in the design of its CFC legislation) to strike a balance between promoting the country's tax competitiveness and ensuring that its tax base is adequately protected.

CFC legislation – The rationale

Groups can create non-resident affiliates to which they shift income, and these affiliates may be established wholly or partly for tax reasons rather than for non-tax business reasons.

CFC and other anti-deferral rules combat this by enabling jurisdictions to tax income earned by foreign subsidiaries where certain conditions are met.

Building blocks for the design of an effective CFC policy framework

The OECD's final report[1] on Action 3 (Designing Effective Controlled Foreign Company Rules) provides six building blocks for countries to design effective CFC rules, i.e.:

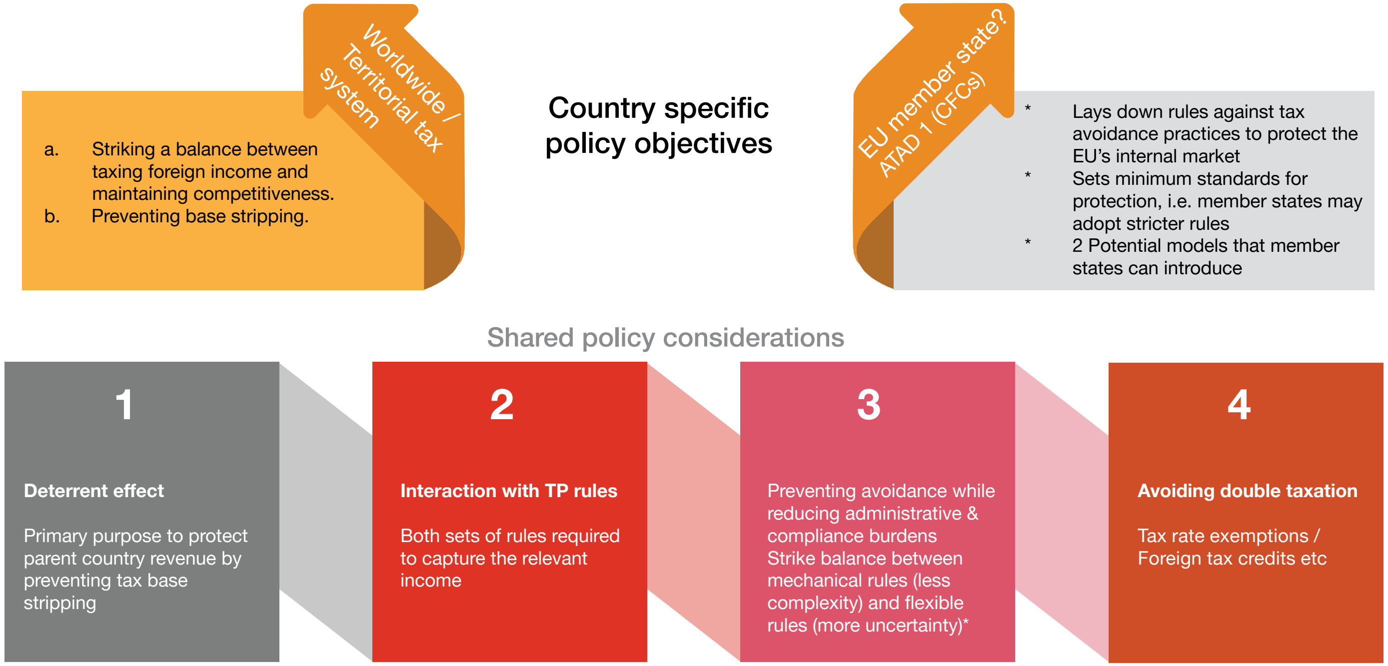
- Rules for defining a CFC (including a definition of control);
- CFC exemption and threshold requirements;
- Definition of CFC income;
- Rules for computing income;
- Rules for attributing income; and
- Rules to prevent or eliminate double taxation.

The report identifies two classes of policy considerations, namely those that –

a. underlie all CFC rules; and
b. are country specific, i.e. the policy objectives that countries may prioritise differently to fit into the specific jurisdiction's overall tax system.

1 OECD/G20 Final Report on Action 3 of the Action Plan on Base Erosion and Profit Shifting (2015), page 14 – 15.

The graphic below summarises and provides more details (as set out in the OECD's report) on these policy considerations.



Note: See *PwC's tax* alert for more details regarding ATAD1.

For purposes of this article, we specifically compare how SA and certain other countries define a CFC's income (with reference to the factors and approaches referred to above) as this is an important

For purposes of this article, we specifically compare how SA and certain other countries define a CFC's income (with reference to the factors and approaches referred to above) as this is an important factor for a government to balance tax base erosion with reduced administrative and compliance burdens in order to ultimately maintain a country's competitiveness in the international market.

[*] The OECD states that this policy consideration (nr 3) is reflected most clearly in the rules defining income and that most countries adopted less mechanical substance analyses to ensure that only income that in fact arises from base erosion and profit shifting is attributed to the parent company for income tax purposes and that CFC rules generally include income that has been separated from the underlying value creation to obtain a reduction in tax.

Depending on the jurisdiction's policy design, it may focus on a combination of the below factors to identify whether there is a risk that the CFC's income has been separated from the underlying value creation to obtain a tax benefit, e.g. :

- whether the income is of a type that is more likely to be geographically mobile;
- whether the income was earned from or with the assistance of related parties;
- the source of the income; and
- the level of activity in the CFC.

Approaches:

- Categorical analysis (e.g. legal classification of types of income more likely to be geographically mobile, i.e. dividends, interest, insurance income, royalties and IP income; sales and services income).
- Substance analysis, i.e. considering whether the CFC is engaged in substantial activities resulting in the CFC's income, referring e.g. people, premises, assets, and risks. The fundamental question is whether the CFC had the ability to earn the income itself.

Most jurisdictions' substance analyses apply alongside more mechanical rules (as opposed to being stand-alone rules). A substance analysis adds to the complexity of CFC rules, but provides the ability to more accurately identify and quantify shifted income.

Defining income

South Africa:

National Treasury's stated policy intent

South Africa tax should apply where failure to tax the foreign controlled company's income will likely lead to an artificial flow of funds offshore, but that a balanced approach (in line with international norms) should be followed to avoid damaging South Africa's international competitiveness. To achieve this balance income stemming from active operations of a CFC is exempt, but the taxation of income derived by a CFC from passive investments or from transactions considered to have a high tax avoidance risk.

– National Treasury's Detailed Explanation to section 9D of the Income Tax Act, dated June 2002

Since SA changed from a source plus to a residence minus system (in January 2001) it has adopted a full inclusion system which treats all income as CFC income, irrespective of its character[2], i.e. the starting point of the SA CFC calculation is to impute an amount equal to the total net income, unless a specific exemption (the high tax exemption / the foreign business establishment (FBE) exemption) is available.

The FBE test allows for the exemption of a CFC's active business income where certain substance requirements are met, i.e. generally if the CFC's premises, staff, equipment and facilities are suitable to conduct the company's primary business operations at its fixed place of business in the foreign country.

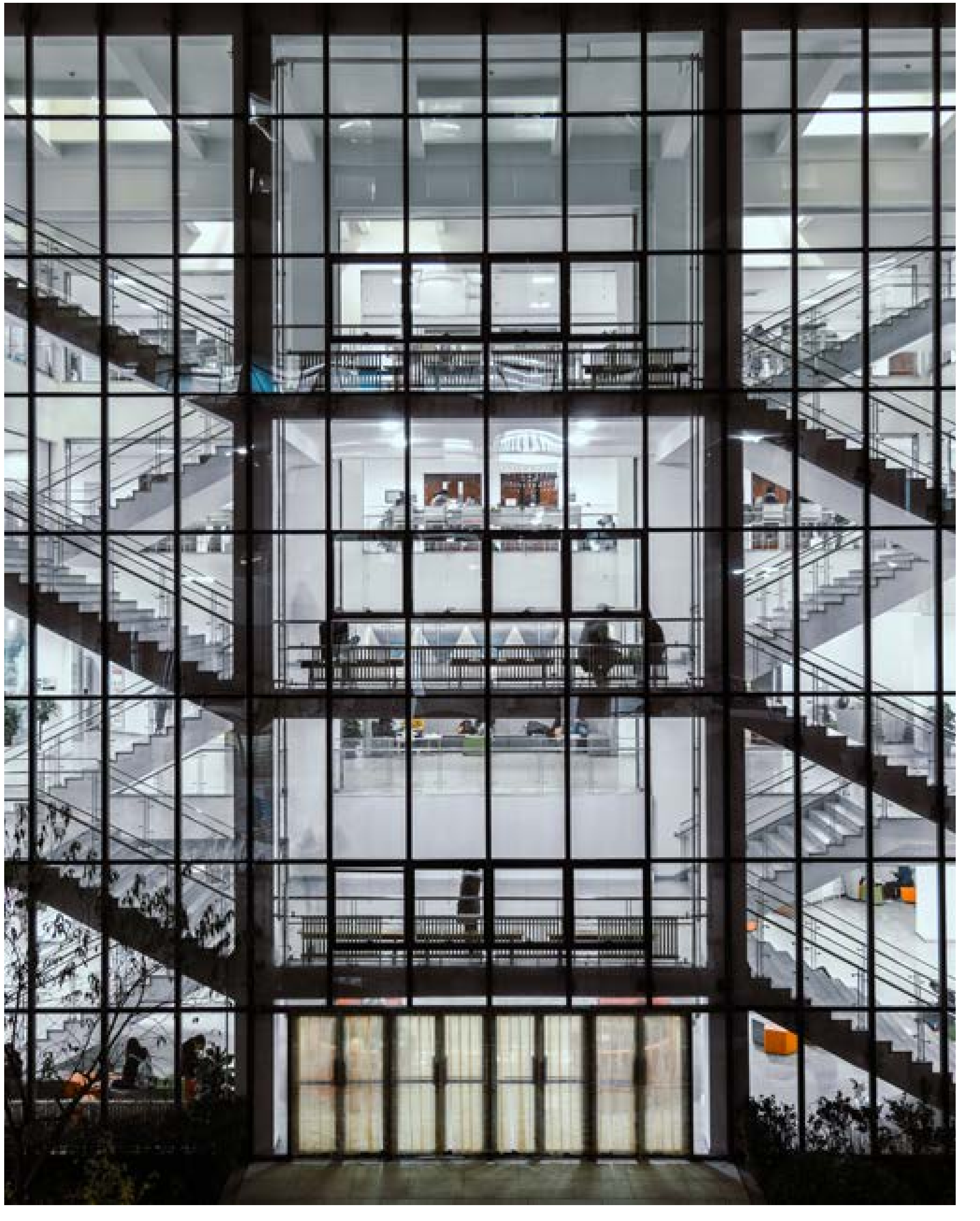
As a general rule, income that is more likely to be geographically mobile (e.g. passive income such as interest and royalties) and diversionary income will be attributed to the SA shareholder for SA income tax purposes.

Foreign jurisdictions

A review of the CFC regimes of a number of jurisdictions reveals that, in contrast to SA's approach, the starting point of most of these jurisdictions is to impute only certain specific types of income (mainly passive income) or active income derived from related party transactions (mainly where these transactions are with entities who are resident in the shareholder jurisdiction).

The review further shows that the other countries do not have similar substance requirements to those contained in the FBE exemption to exclude active business income of a CFC from imputation to the parent entity.

The table below reflects which factors the respective countries consider in order to identify whether there is a risk that a CFC's active income has been separated from the underlying value creation to obtain a tax benefit and the approach they adopt in respect of this income.



2 Prior to 2001, section 9D provided for the taxation of certain controlled foreign entities' passive income (e.g. interest, annuities, rentals and royalties) only.

Country	Approach
Australia	Income from active business operations of the CFC will only be imputed to the extent the income has a connection with Australia (i.e. 'tainted sales' or 'tainted services' income). Where there is no connection with Australia and the active income test is passed there should be no attribution of the CFC's income.
Canada	A CFC's undistributed active income will only be attributed to the Canadian parent if it is generated from transactions with a Canadian resident connected person.
UK	The UK CFC rules are largely focused on whether profits are being diverted away from the UK. A CFC's business profits are exempt from UK tax unless the CFC has UK-managed assets or bears any UK-managed risks. This income may still be exempt in terms of other tests.
USA	Sales and service income with related parties will generally be imputed, regardless of where they are based (except for instances where the sales/services take place in the CFC's country).
EU member countries:	
Belgium	Belgium's CFC rules are aimed at non-distributed income from predominantly tax driven arrangements. Active income will only be imputed if it arises from an arrangement where the Belgian resident company takes the strategic decisions regarding the assets and/or risks of the CFC and this arrangement was put in place for the essential purpose to obtain a tax advantage.
Germany	If the CFC is not resident in a non-cooperative state, its trade/business income is only at risk of imputation if it results from transactions with German resident affiliate companies and the CFC does not meet the commercial substance requirements. To meet the commercial substance requirements, there must be proof that the foreign company maintains a business operation set up for commercial transactions in a commercial manner and participates in general commercial transactions and carries out the activities associated with the preparation, conclusion and execution of the transactions without the involvement of such German (affiliate) tax residents.
Ireland	No imputation provided that the significant people functions and key entrepreneurial risk taking functions of the CFC are performed outside Ireland.
Luxembourg	Targeting non-distributed income of CFCs arising from non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage. No imputation provided that the significant people functions and key entrepreneurial risk taking functions of the CFC are performed outside Luxembourg.
Netherlands	No imputation, provided the CFC carries out genuine economic activities (i.e. meets the substance requirements) in its country of establishment. The substance requirements are as follows: • At least 50% of the statutory board members (with decision making powers) of the entity are residing in the country of which the entity is resident; • The board members resident in the state of which the entity is resident are sufficiently qualified to perform their tasks properly. This includes at least: - decision making on the entity's transactions, under the entity's own responsibility and within the framework of the normal corporate involvement, and - proper completion of the transactions that *the entity will perform;* • The entity must have sufficiently qualified personnel at its disposal for the processing and registration of the transactions; • The board decisions are (materially) made in the state of which the entity is resident; • The most important bank account(s) of the entity are held in the state of which it is resident; • The administration and bookkeeping of the entity physically takes place in the state of which it is resident; • The entity incurs wage costs of at least (the equivalent of) EUR100k in relation to its activities; and • The entity has for at least 24 months office space at its disposal in the state of which it is resident which is in fact used to carry out its activities. If the CFC meets the substance requirements, it creates a rebuttable presumption of genuine economic activities within the CFC.

The takeaway

[SA] should follow and not lead or set the trend [in respect of the design of CFC rules]

– Davis Tax Committee's Report on OECD Action 3: Strengthening Controlled Foreign Company Rules

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It is clear that SA's current CFC legislation is more stringent than that of many other countries, the unfortunate result being that SA-based multinational companies (potentially subjected to higher effective tax rates due to the SA CFC provisions) may be less competitive than multinational companies based in countries that have less restrictive CFC legislation.

We accordingly agree with the Davis Tax Committee's comments that given SA's (limited) status on the global stage, there is absolutely no need to strengthen the current legislation. Rather, to give effect to National Treasury's stated policy of striking a balance in the CFC rules, the SA government would be well advised to consider adopting a regime that is more closely aligned with the international norms to boost SA's international competitiveness. That would mean that, when it comes to active income, SA should consider relaxing its onerous FBE requirements and concern itself only with profits of a CFC that are diverted from related parties in SA.

Secondment of non-resident employees to South Africa… to tax or not to tax?

On 20 September 2023, the Gauteng High Court delivered its judgment in the case of Citibank, N.A. South African Branch, Citigroup Global Markets (Pty) Ltd v The Commissioner for the South African Revenue Service ("SARS").

The Court found in favour of SARS as there was insufficient evidence to support the applicant's contention that secondees were in fact their employees. The court therefore found that the services received from the Sending Home Entities constituted "imported services" as defined for VAT purposes and subject to 15% VAT for the applicants.

Brief overview

Citibank, N.A. (South African Branch) and Citigroup Global Markets (Pty) Ltd, together referred to as "the Receiving Home entities" or "the applicants", made an application to the Gauteng High Court for declaratory relief relating to what was referred to by the court as a "weighty issue".

The application required the court to confirm that payments made by the Receiving Home entities to Citigroup Inc. ("the Sending Home entity") in relation to employees seconded, constitutes a reimbursement of salary costs and not the supply of imported services.

SARS ("the Respondent") opposed the application.

Background

Citigroup Inc is a global group of companies carrying on the business of a bank. The group has various branches throughout the world, including South Africa ("SA") and as part of operating as a group, employees are seconded to various countries, including to SA.

In doing so, two agreements were entered into by the relevant entities as follows:

1. Firstly, it enters into an assignment agreement with the employee that defines the terms of the secondment.
2. Secondly, Citigroup also enters into an inter-company agreement called an "Intra-City Services Agreement" with the Receiving Home entities.

Both of these agreements refer to the secondment as an agreement "for the supply of employee services."

The Sending Home entity is a non-resident and not required to register for VAT in SA.

Both the Receiving Home entities are registered VAT vendors and they make both taxable and exempt supplies. The services acquired by them were acquired and not used or consumed wholly for purposes of making taxable supplies.

It is assumed that the applicants considered these payments to constitute remuneration paid to an employee, and therefore the Receiving Home entities did not have any VAT implications on the payment made to the Sending Home entity.

However, if these payments constitute consideration for a supply of services by a non-resident, the Receiving Home entities had a liability to account for VAT on imported services.

In view of the above, the Receiving Home entity made an application for declaratory relief to confirm that payments made by it to the Sending Home entity for employees seconded, constitutes a reimbursement of salary costs and not for the supply of imported services as defined for VAT purposes.

The law

A person is regarded as carrying on an enterprise in SA if such person carries on an activity:

- continuously or regularly;
- in the Republic or partly in the Republic; and
- in the course or furtherance of which goods or services are supplied to any other person for a consideration.

However, a person is excluded from carrying on an enterprise if that person is an employee earning "remuneration" in the form of a salary or wage from its employer, in terms of proviso (iii)(aa) to the definition of an "enterprise".

A person carrying on an enterprise in SA is required to register, levy and account for VAT, generally at the standard rate of 15%.

The term "imported services" refers to a supply of services made by a non-resident supplier to a SA resident to the extent that such services are utilised or consumed in SA, otherwise than for the purpose of making taxable supplies.

In terms of section 7(1)(c), VAT at the rate of 15% is payable on the acquisition of imported services (i.e. VAT is payable by the recipient to the extent that it acquires the services for non-taxable purposes).

Section 7(1)(c) is however subject to the exemptions provided for in section 14.

Section 14(5) provides for, inter alia, the following to be exempt from VAT being levied on the payment of imported services where -

- the supply is chargeable with VAT under section 7(1)(a), that is, the supplier is registered (or required to be registered) for VAT in SA and required to charge VAT on the supply; and
- the person supplying the service is an employee and receives a salary or wage from its employer.

Agreements between the parties

In order to decide on the relief sought by the applicant, it was important for the court to analyse the contents of the agreements between the parties.

The assignment agreement

This agreement provides the following:

- The Sending Home entity lends the services of the seconded employees to the Receiving Home entity.
- The lending arrangement is done in terms of an inter-company agreement between the entities termed "for the supply of employee services".
- The seconded employee will be on an "expatriate assignment".
- A person seconded by the Sending Home entity remains an employee of the Sending Home entity (i.e. during this time the person will not be an employee of the Receiving Home entity).
- A seconded employee is also not an employee of Citigroup, N.A.
- Citigroup, N.A. administers the "expatriate salary and benefits" of a seconded employee as agent on behalf of the Sending Home entity.

The intra-city agreement

This agreement refers to the parties as a "service recipient" and "service provider".

The price for the services is generally based on a "cost plus mark-up" structure. That is, the cost of the services which includes salaries, benefits, incentive compensation and other expenses related to personnel engaged in the rendering of the service plus a mark-up that is charged by the service provider to the service recipient.

Applicant's arguments

The applicants (i.e. the Receiving Home entity) argued that the seconded employees were in fact their employees and that payments made to the Sending Home entities therefore constituted the reimbursement of salary costs paid to its own employees on their behalf, and should therefore not be subject to VAT in terms of section 7(1)(c). This was based on the exclusion to the definition of an enterprise under proviso (iii)(aa) referred to above.

The applicants contended that the employees were their own, based on:

1. the employee's productive capacity being at the disposal of the applicants;
2. the employees furthered the enterprise of the applicants in the course of their employment;
3. the applicants have the right of supervision and control over the employees;
4. in exchange for the use of the employees' services, the applicants paid the Sending Home entity for the supply of the seconded employees' services (without any mark-up), who in turn paid the employee; and
5. the employees received remuneration for their services to the applicants and the applicants deducted and withheld employees tax from the remuneration paid as their employer.

It was also stated that the employees are also employed by the Sending Home entity. The applicants further submitted that even if imported services were applicable, it was still exempt from VAT under subsection 14(5)(d) which exempts services of an employee from imported services.

The applicants maintained that the reimbursement of the salary costs fell outside the scope of VAT.

SARS' arguments

SARS disagreed and stated that the issue is not whether the employees are that of the applicants but whether the services supplied by the Sending Home entities fall within the ambit of "imported services" in terms of section 7(1)(c).

Mainly, SARS disputed the relationship between the parties, in particular it questioned whether the seconded individuals are "employees" of the applicants.

It was emphasised by SARS that tax legislation defines "employees" differently from what constitutes an employee for labour law purposes and that the seconded personnel are not employees for purposes of the VAT Act or the Fourth Schedule to the Income Tax Act.

SARS further disputed that the Sending Home entity pays the salaries on behalf of the applicants and that the applicants reimburse the Sending Home entity.

SARS pointed out that:

- the individuals in question are made available under the intra-city agreement by the service provider (Sending Home entity) for payment of a fee; and
- the assignment agreement expressly confirms that seconded individuals remain employees of the Sending Home entity and that salaries are administered by Citigroup, N.A. on behalf of the employer (i.e. Sending Home entity).

SARS submitted that there was no evidence to support that seconded employees reported directly to the applicants or that they were under the supervision and control of the applicants.

SARS reiterated that the intra-city agreement did not support the applicant's contention that the individuals were their employees and that the Sending Home entities were obliged to pay the salaries on behalf of the applicants. Instead, this agreement made it clear that the Sending Home entity is a service provider, providing services of making employees available for a fee.

Court's analysis

In its analysis, the court indicated that the applicants should have demonstrated that:

- the applicants are the employers as envisaged in the proviso to "enterprise";
- the seconded employees are those of the applicants;
- the secondees render services in the course of their employment with the applicants; and
- the applicants pay the seconded employees a "remuneration".

Given that the relief deals with a taxation issue, the court found that the applicants failed to show why the relationship should have only been considered under labour laws and not tax laws. The court found that the meaning of the three important concepts of "employee", "employer" and "remuneration" (which are key to the issue at hand and the subject matter of the relief sought) should have been considered under the tax laws.

The court further stated that the applicants did not substantiate what constitutes "supervision and control". The court found that the applicants merely recited what is said in the Fourth Schedule to the Income Tax Act[1] but did not actually show how the employees were under their supervision and control, for example looking at restrictions placed on the employees in terms of, for example, leave days.

In summary, the court concluded that the application faulted on mainly two respects:

1. Firstly, the applicants did not show that they were the employers.
2. Secondly, the applicants failed to demonstrate that the payments to the Sending Home entity were "remuneration" as defined.

For these reasons, the court dismissed the application with costs.

1 Act No. 58 of 1962.

Our comments

The judgment effectively confirms that the secondment of employees in these circumstances constitutes a supply of services, as the employees remain that of the Sending Home entity.

In arriving at this judgment, the court was not convinced due to the insufficient evidence provided by the applicants to argue and demonstrate that the secondees were in fact their employees as envisaged in the Fourth Schedule to the Income Tax Act and the proviso (iii)(aa) to the definition of enterprise in the VAT Act.

Due to the lack of evidence and based on the analysis of the two agreements, the court viewed the provision of the seconded employees as services. As these services were not wholly used for taxable purposes by the applicants, the applicants were liable for VAT on imported services.

It must be emphasised that the courts have on numerous occasions highlighted the importance of contracts when analysing the VAT implications of a transaction. In the case of *C:SARS v Respublica (Pty) Ltd*[2] the court stated that *"the VAT consequences of a supply must be assessed by reference, first and foremost, to the contractual arrangements under which the supply is made"*.

In the current case, the court had to consider and also gave proper weighting to the two agreements entered into by the Group which underpins the secondment arrangements. Considering the pertinent terms of these agreements, it evidenced the arrangement of a service provider/recipient relationship more than anything else.[3]

This case therefore once again emphasises the importance of contractual relationships and the need for accurate contracting. That is, the contract must be detailed, clear and explicit and not just recite the wording of a statute. Furthermore, the implementation of the contract is critically important to support the intention of the parties.

In our view, if the agreements and the evidence supported the applicant's contention that the seconded employees were indeed its employees, it would have likely been successful in its application and the court would have confirmed that it was not liable for VAT on imported services.

Practical implications

It is interesting to see the approach adopted here by SARS, considering that historically SARS was of the view that the activity of making available employees by a non-resident to a SA resident constitutes an "enterprise" for SA VAT purposes with the obligation to register for and charge SA VAT.

In other words, where a non-resident entity seconded its employees on a continuous or regular basis to an SA entity, the non-resident would be carrying on an enterprise in SA. As such, the non-resident entity was required to register as for VAT and levy and account for VAT at 15% in respect of these services.

If this approach was consistently applied by SARS, the issue of imported services would never arise as the Sending Home entity would have registered for and charged VAT to the Receiving Home entity.

The historical view by SARS and its defence in the current judgment is contradictory and controversial. It is only through this judgment that the taxpaying public is aware of this opposing view by SARS. This, in our view, highlights the immediate action required from SARS to firstly decode the outcome of this judgment, and secondly to implement a process to ensure proper communication around the change of its interpretive policy.

The decoding of the outcome of this judgment by SARS should consider and address the following:

- Based on the historical SARS view, many non-resident entities registered as vendors in respect of similar activities. Should these entities remain registered for VAT (bearing in mind many of these entities received VAT Rulings issued by SARS confirming their obligation to register for VAT in SA) or apply for deregistration?
- In some cases, the VAT registrations were required to be backdated resulting in penalties and interest payable by those vendors. Would these entities be entitled to a refund of tax, penalties and interest paid by these vendors?
- Are the recipient entities at risk of not declaring VAT on imported services where this is applicable?

Despite the above and looking forward to ensuring that VAT is adequately dealt with, it is important for vendors to properly analyse whether any seconded personnel are the employees of such a vendor as envisaged in the Fourth Schedule to the Income Tax Act read with the VAT Act to determine whether any liability for VAT on imported services exists.

In addition, it is advisable for any non-resident supplying seconded employees who have registered as vendors to consult and approach SARS for certainty and alignment before taking any steps to deregister.

2 [2018] ZASCA 109 par [12].

3 Note that our analysis is based on the information available from the judgment and we have not had sight of the actual agreements to analyse.

Transfer pricing implications

From a transfer pricing perspective there are also several observations and lessons from this case.

First, the distinction between the scenario where the foreign Sending Home entity is rendering a service to the Receiving Home entity (with the individual remaining an employee, and under the supervision, of the Sending Home entity) and the scenario where the employee in fact "belongs" to the Receiving Home entity, is critical. Not only does this impact the appropriate remuneration the Sending Home entity is entitled to, but it also speaks to the delineation of functions and risks when comparing the two entities.

A second critical point is that of actual practical evidence. It is not sufficient to rely solely on assertions and legal contracts (and so forth) but, rather, the true nature of the relationship for transfer pricing purposes is determined also with reference to actual behaviour and demonstrable evidence.

Employees' tax implications

Whilst the case relates to the VAT implications of employees seconded to SA, there are employees' tax considerations, however, we caution against reading too much into the judgement from an employment tax perspective.

In this case PAYE was accounted for by the Receiving Home entities; however, it appears that the court was not persuaded that this action implied that the seconded employees were employees of the Receiving Home entities.

In our opinion, it is evident that the court required the Receiving Home entities to demonstrate that the seconded employees were, in fact, their employees, as envisaged in the Fourth Schedule of the Income Tax Act. In this regard, it appears that such evidence was not provided/substantiated to the court and, instead, reliance was placed merely on stating that the employees were under the supervision and control of the Receiving Home entities in support of that position.

Not only is it critical that a detailed analysis is performed to ensure that the employees would be considered employees of the Receiving Home entities but also the respective agreements need to align to the position being taken which must in turn align with the factual position.

In other words, if employees are being seconded, the respective agreements should preferably not be ones in terms of which services are being provided by the foreign employer but rather actual employees and their productive capacity.

Key takeaway

The decision will not impact companies that use or consume the seconded employees' services wholly for taxable purposes since VAT on imported services is only payable to the extent that the services are utilised for non-taxable purposes.

However, companies that use or consume the services of seconded employees partly or wholly for non-taxable purposes may be impacted.

Based on the historical SARS view, many non-resident entities are registered as vendors in respect of seconding employees to SA entities and, in some instances, these VAT registrations were backdated resulting in penalties and interest payable by those vendors. This decision, and the manner in which SARS argued the case, creates uncertainty as to SARS' current position on secondment arrangements.

It is therefore important that these companies revisit their contracts and the implementation thereof to ensure that it is adequate to support its position as the employer of the seconded employee.

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SARS Watch

SARS Watch 1 October 2023 – 31 October 2023

Legislation		
27 Oct 2023	Notice 4011 – Publication of explanatory summary of the Tax Administration Laws Amendment Bill, 2023	Published in Government Gazette No. 49576 with implementation date of 27 October 2023.
25 Oct 2023	Draft Response Document and Response slides on the 2023 Draft Tax Bills	National Treasury and SARS published Draft Response Document and Response slides on the 2023 Draft Revenue Laws Amendment Bill, 2023 Draft Revenue Administration and Pension Laws Amendment Bill, 2023 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2023 Draft Taxation Laws Amendment Bill and 2023 Draft Tax Administration Laws Amendment Bill.
Interpretation		
31 Oct 2023	Interpretation Note 112 (Issue 2) – Section 18A: Audit certificate	This Note provides guidance on the interpretation and application of section 18A(2B) and (2C) of the Income Tax Act 58 of 1962 ('ITA') in relation to the audit certificate that must be obtained and retained in specified circumstances for section 18A receipts issued by an approved organisation or department.
31 Oct 2023	Interpretation Note 24 (Issue 5) – Public benefit organisations: Partial taxation	This Note provides guidance on the interpretation and application of section 10(1)(cN) of the ITA, which provides for two different kinds of exemptions, namely – • the exemption from income tax of the receipts and accruals of a PBO to the extent that the receipts and accruals are derived from – - carrying on its PBAs; and - permissible business undertakings or trading activities; • a basic exemption to the extent that the receipts and accruals fall within the thresholds provided.
4 Oct 2023	Interpretation Note 51 (Issue 6) – Pre-trade expenditure and losses	This Note provides guidance on the deduction of pre-trade expenses (sometimes also called start-up costs) under section 11A of the ITA.
Binding rulings		
25 Oct 2023	Binding General Ruling 62 (Issue 2) – Value-added tax implications of securities lending arrangements	This ruling clarifies the Value-Added Tax ('VAT') consequences for a lender in respect of the consideration that the lender charges in terms of a securities lending arrangement.
13 Oct 2023	Draft Binding General Ruling 16 (Issue 3) – Standard Turnover-based Method of Apportionment	Comments are due to SARS by Friday, 3 November 2023.

Customs and excise

27 Oct 2023	Notice R.4008 - Amendment to Part 1 of Schedule No. 1, by the substitution of Additional Note 6(a) to Chapter 22, to clarify that the products classifiable in tariff subheading 2206.00.19 is limited to beverages that are the end product of fermentation of a liquor (wort) of non-malted milled cereals listed in the table in Chapter Note 2 to Chapter 11, whether or not flavoured but not mixed with any other beverages, provided the fermentable sugars are derived solely from the liquor (wort) without the addition of any other sugars during or prior to fermentation	Published in Government Gazette No. 49557 with retrospective effect from 21 February 2021.
20 Oct 23	Draft amendments to Part 1 of Schedule No. 1 – Insertion of Additional Note 8 to Chapter 22	Comments are due to SARS by Monday, 20 November 2023.
20 Oct 2023	Draft amendments to Part 1 of Schedule No. 1 – Insertion of tariff subheading 2009.89.70 and 2009.90.30 to provide for nut juices in subheading 2009.89 and mixtures of nut juices in subheading 2009.90	Comments are due to SARS by Friday, 3 November 2023.
19 Oct 2023	Draft amendments to rules under section 120 – Advance import payments	Comments are due to SARS by Friday, 3 November 2023.
13 Oct 2023	Draft amendments to rules under sections 64E and 120 – Accreditation of clients	Comments are due to SARS by Friday, 3 November 2023.
6 Oct 2023	Updated Customs State Warehouse procedure	The procedure for the release, auction, donation, and destruction of goods has been updated to: • include the process models; and • make provision for the State Warehouse Inventory Management System (SWIMS) functionality.

Case law

In accordance with the date of judgment

11 Oct 2023	Commissioner for the South African Revenue Service v Majestic Silver Trading 275 (Pty) Ltd and Others (B445/2023) [2023] ZAGPPHC 1791	On 14 February 2023 the court, on application by SARS, granted a provisional preservation order in terms of s163 of the Tax Administration Act 28 of 2011 against a company, trust and certain individuals with outstanding tax debts (except for the eighth respondent). The taxpayers sought to have the preservation order discharged on an anticipated return day thereof. The question now is whether assets should be preserved (and liquidated) in order to discharge the taxpayers' debts.
9 Oct 2023	Silverback Technologies CC & Others v CSARS (301/2022) [2023] ZASCA 128	The issue is the classification, for purposes of customs duty, of certain bicycle parts imported into the country for use in assembling bicycles in order to determine the taxpayer's liability for import duties, if any.
3 Oct 2023	Sasol Chevron Holdings Limited v CSARS (CCT 149/22) [2023] ZACC 30	This matter concerns the interpretation and application of s7(1) of the Promotion of Administrative Justice Act and the procedures for the granting of VAT refunds to qualifying purchasers conducting business in export countries in terms of the regulations issued under section 74(1) read with paragraph (d) of the definition of "exported" in section 1 of the Value-Added Tax Act 89 of 1991 ('VAT Act').

3 Oct 2023	Nu Africa Duty Free Shops (Pty) Ltd v Minister of Finance and Others; CSARS v Ambassador Duty Free (Pty) Ltd and Others; Minister of Finance v Ambassador Duty Free (Pty) Ltd and Others (CCT 29/22; CCT 57/22; CCT 58/22) [2023] ZACC 31	The first application is brought by Nu Africa Duty Free Shops (Pty) Limited (Nu Africa) for the confirmation of an order of constitutional invalidity of section 75(15)(a)(i)(bb) of the Customs Act, section 74(3)(a) of the VAT Act as well as certain amendments to Schedule 4 and 6 of the Customs Act and to Schedule 1 to the VAT Act made by the High Court. The other two applications are for leave to appeal the High Court's judgment and order and oppose the confirmation of constitutional invalidity.
29 Sept 2023	Commissioner for the South African Revenue Service v Absa Bank Limited and Another (596/2021) [2023] ZASCA 125	This appeal concerns the exercise of the High Court's review jurisdiction in the context of a tax assessment raised in terms of s80B of the ITA.
Guides and forms		
31 Oct 2023	Guide to Section 18A Approval of a Department in the National, Provincial and Local Sphere of Government	This document provides guidance on – • the meaning of the government of South Africa in the national, provincial and local sphere contemplated in section 10(1)(a); • the approval of a department of government contemplated in section 10(1)(a) by the Commissioner under section 18A(1)(c) to issue section 18A receipts for bona fide donations received; and • a section 18A-approved department of government's obligation to use bona fide donations for which section 18A receipts were issued for purposes of only a public benefit activity in Part II of the Ninth Schedule in South Africa.
30 Oct 2023	Guide to submit a dispute via eFiling	This guide is designed to assist taxpayers with the submission of the Request for Remission (RFR), Notice of Objection (NOO), Notice of Appeal (NOA), Request for Reason, Request for Late Submission (Condonation) and the Suspension of Payment form on eFiling when disputing the interest and penalties levied, assessments raised and/or administrative penalties levied for Personal Income Tax (PIT), Corporate Income Tax (CIT), Value-Added Tax (VAT) and Pay-As-You-Earn (PAYE), including Employment Tax Incentive (ETI), Unemployment Insurance Fund (UIF) and Skills Development Levy (SDL).
30 Oct 2023	How to register for the use of the SARS MobiApp – External Guide	This guide demonstrates how to register for the purpose of making use of the SARS MobiApp in taxpayers' tax compliance responsibilities.
30 Oct 2023	Guide to the Tax Compliance Status functionality on eFiling	This guide is designed to assist taxpayers on how to utilise the Tax Compliance Status functionality on eFiling to obtain a security PIN. In addition, the guide explains the functionality available to the third party to verify the Tax Compliance Status of a taxpayer from whom it received the PIN.
13 Oct 2023	Comprehensive Guide to the ITR12 Income Tax Return for Individuals – External Guide	This document provides guidance for the completion of the ITR12 return and briefly explains the various sections of the ITA that will be applied during the assessment process.
13 Oct 2023	Guide on the Taxation of Farming Operations	This guide is a general guide regarding the taxation of farming operations in South Africa.
6 Oct 2023	State Warehouse – External Policy	The purpose of this external policy is that: • Goods liable to forfeiture and pending compliance to any condition of the Act may be stored in the State Warehouse or a place deemed to be a State Warehouse. • Goods may only be released from the State Warehouse after Customs clearance has been made. • Customs disposes of goods that are abandoned, prohibited or remain unentered after sixty (60) days.
6 Oct 2023	• Registration Licensing and Designation – External Policy • Documentary Requirements – External Annexure • Customs Trader Portal – External Guide • SARS Online Query System – External Guide	These documents have been updated to include conditions for when an application for the renewal of a license will be auto-approved, as well as the requirements for the registration of diesel food manufacturers. The SARS Online Query System external guide has also been updated to include the new query option that will enable diesel food manufacturers to submit applications and supporting documents electronically.

5 Oct 2023	VAT 409 – Guide for Fixed Property and Construction (Issue 7)	This guide is a general guide concerning the application of the VAT Act in connection with fixed property and construction transactions in South Africa.
4 Oct 2023	Basic Guide to Section 18A Approval (Issue 5)	This guide has been prepared to assist organisations in understanding the basic requirements for obtaining and retaining approval under section 18A of the ITA.
2 Oct 2023	• Refunds and Drawbacks – External Policy • Refund Supporting Documents – External Annexure • Customs Worksheet for Schedule 5 – External Annexure • Marking Off 521 Permits Imports – External Annexure • State Warehouse Worksheet – External Annexure • Allocation Codes – External Annexure • Grain Short Landed Certificate – External Annexure • Completion of CR1 – External Annexure • Completion of DA 63 – External Annexure • Completion of DA 64 – External Annexure • Completion of DA 66 – External Annexure • Excise Refunds Supporting Documents – External Annexure • Receipts of imported goods into the VM – External Annexure • Examples of Diesel Refund on Foodstuff – External Annexure	The new Diesel Refund for Foodstuff Manufacturers has been incorporated in the Refunds and Drawback Policy, and these documents have been updated and/or published.
Other publications		
31 Oct 2023	ATAF: ATAF and OECD renew partnership to strengthen tax co-operation in Africa	The African Tax Administration Forum (ATAF) and the Organisation for Economic Cooperation and Development (OECD) signed a renewal of their Memorandum of Understanding (MoU) for a period of five years, agreeing to continue to work together towards the common objective of promoting fair and efficient tax systems and administrations in Africa.
31 Oct 2023	OECD: Africa's tax revenues remain below pre-pandemic levels in 2021 as financing challenges worsen	Africa's average tax-to-GDP ratio was 15.6% in 2021, unchanged from the previous year and remaining below its pre-pandemic levels, according to the 2023 edition of Revenue Statistics in Africa. The report's findings underscore the financing challenges facing African countries as a result of the COVID-19 pandemic.
27 Oct 2023	Tax Alert: 2023 Draft tax bills – National Treasury's and SARS' response to public comments	On 25 October 2023, National Treasury and SARS responded to public comments, received during the Standing Committee of Finance (SCoF) meetings in September 2023 and in public workshops, on the proposed 2023 tax legislation. Importantly, the proposed amendment to the Foreign Business Establishment (FBE) exemption will be withdrawn pending the Constitutional Court judgment in the Coronation case and Practice Note 31 (PN 31) will remain in effect until 1 January 2025 for further consultations.

24 Oct 2023	Tax Policy Alert: EU Directive (DAC8) adopts wider reporting requirements for crypto and other transactions	The Council of the EU adopted, on 17 October 2023, a Directive amending the EU rules on administrative cooperation in the area of taxation (DAC8). The amendments primarily pertain to the reporting and automatic exchange of information on certain revenues from crypto asset transactions and the provision of advance tax rulings for the wealthiest (high net worth) individuals. The Directive aims to strengthen the existing legislative framework by broadening the scope for registration and reporting obligations and improving overall administrative cooperation between tax administrations.
18 Oct 2023	Tax Policy Alert: Council of the EU approves changes to the EU list of non-cooperative jurisdictions	The European Finance Ministers, sitting as the Council of the EU, approved the recommendations of the EU Code of Conduct Group in relation to the updated list of non-cooperative jurisdictions. Three jurisdictions, Antigua and Barbuda, Belize, and Seychelles were all added to Annex I (the so-called EU blacklist). British Virgin Islands, Costa Rica, and Marshall Islands were removed from the previous Annex I list (published in February 2023). Annex II of the list (greylisted countries) was also updated with four jurisdictions removed from the state of play document: Thailand, Montserrat, Jordan and Qatar.
16 Oct 2023	OECD: International tax reform: Multilateral Convention to Implement Amount A of Pillar One [webinar]	In this webinar, OECD experts explored key aspects of the MLC: • Applying Amount A rules • Tax certainty framework for Amount A and related issues • Removal and standstill of digital services taxes and relevant similar measures
16 Oct 2023	OECD: OECD Tax Talks #22	Experts from the OECD Centre for Tax Policy and Administration presented an update on recent developments in the OECD's international tax agenda.
13 Oct 2023	OECD: Heads of tax administrations agree on new collaborative initiatives to shape the future of tax administration and on deepening their co-operation for the implementation of the global minimum tax	The OECD's Forum on Tax Administration (FTA) held its annual Plenary meeting in Singapore from 11-13 October 2023, bringing together tax commissioners and delegates from across the globe, including representatives from international organisations, regional tax administration bodies, business and academia. At the meeting, Commissioners agreed on new areas of collaboration to pave the way for transforming the future of tax administration.
12 Oct 2023	OECD: New report reflects on the OECD's co-operation with Africa on tax matters	This report reflects on the OECD's co-operation with Africa on tax matters and the importance of the international tax agenda for African economies.
11 Oct 2023	Tax Alert: VAT implications on the secondment of non-resident employees to South Africa	On 20 September 2023, the Gauteng High Court delivered its judgment in the case of *Citibank, N.A. South African Branch, Citigroup Global Markets (Pty) Ltd v Commissioner for the South African Revenue Service*. The Court found that there was insufficient evidence to support the applicant's contention that the secondees were in fact their employees, and found that the services received from the Sending Home Entities were indeed 'imported services' as defined for VAT purposes, subject to 15% VAT. This Alert provides more details on the matter.
11 Oct 2023	OECD: OECD/G20 Inclusive Framework releases new multilateral convention to address tax challenges of globalisation and digitalisation	The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (Inclusive Framework) has released the text of a new multilateral convention that updates the international tax framework to co-ordinate a reallocation of taxing rights to market jurisdictions, improve tax certainty, and remove digital service taxes.
5 Oct 2023	Tax Policy Alert: MLI implementing the Pillar Two Subject to Tax Rule opens for signature	On 3 October 2023, the OECD Inclusive Framework (IF) announced the conclusion of negotiations on a multilateral instrument (MLI) to implement the Pillar Two Subject to Tax Rule (STTR). The text of the STTR MLI, along with an explanatory statement, high-level summary ('at a glance'), and frequently asked questions (FAQs) can be found on the OECD website. As of 2 October 2023, the MLI is open for signature by all states without reservations. This Alert provides more details.
3 Oct 2023	OECD: International community adopts multilateral convention to facilitate implementation of the global minimum tax Subject to Tax Rule	The new Multilateral Convention to Facilitate the Implementation of the STTR is an integral part of the Two￾Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy. It aims to protect the right of developing countries to ensure multinational enterprises pay a minimum level of tax on a broad range of cross-border intra-group payments, including for services.